Chapmans
CHARTERED ACCOUNTANTS

Upcoming changes for property investors

The government announced significant changes yesterday in an attempt to cool the housing market. As part of this announcement there are some important tax changes proposed that will significantly impact property investors. These are outlined below:

1. Extend the bright line test to 10 years (and amend the main home exemption).

2. Remove interest deductions against residential rental property.

Bright line extension to 10 years

Under current legislation, if a property is brought and sold within 5 years and does not qualify for an exemption any gain on sale is taxable. However, please note where the land is subject to tax as part of a major development for example, those rules prevail.

Inland Revenue have been hot on this for a while now and we have already received letters from them identifying clients as potentially falling within the bright line rules.

Yesterday the government announced that the current bright line test will be extended to 10 years. This will apply to residential property acquired **on or after 27 March 2021**. Property acquired before this date remains subject to the old rules. In summary:

1. Property acquired on or after 1 October 2015 and sold within 2 years was taxable under the old 2 year rule (provided an exemption did not apply).

2. Property acquired on or after 29th March 2018 (but before 27th March 2021) and "new builds" are subject to the 5 year rule.

3. Property acquired on or after 27th March 2021 (with the exception of "new builds") will be subject to new the 10 year rule.

Inland Revenue are yet to clarify what exactly qualifies as a "new build" but it is expected to include property acquired within a year of receiving code of compliance.

Please note there are still exclusions that may apply (ie the main home or inherited property). However, the government is also proposing to amend the main home exemption to introduce a 'change of use' rule that will apply where a property was not used as the owner's main home for more than 12 months at a time within the applicable bright-line period.

The application of the bright line period can also be tricky when working out the start date and end date and the date a property was acquired for the purposes of these rules. We always recommend seeking accounting advice prior to entering into a sale and purchase agreement to buy or sell your property to ensure you understand your potential obligations under bright line or any other land taxing provisions.

Removal of interest deductions

From **1 October 2021** investors will not be allowed a tax deduction for interest on loans used to acquire residential rental property. This applies to residential property acquired **on or after 27th March 2021**.

For property acquired before this date the ability to deduct interest will be phased out over time, as follows:

Income year	**Percent of interest you can claim**
1 April 2020 – 31 March 2021	100%
1 April 2021 – 31 March 2022 (transitional year)	1 April 2021 to 30 September 2021 - 100% 1 October 2021 to 31 March 2022 - 75%
1 April 2022 – 31 March 2023	75%
1 April 2023 – 31 March 2024	50%
1 April 2024 – 31 March 2025	25%
1 April 2025 onwards	0%

If money is borrowed on or after 27 March 2021 to maintain or improve property acquired before 27 March 2021, it will be treated the same as a loan for a property acquired on or after 27 March 2021. Interest will not be able to be claimed as an expense from 1 October 2021.

Property developers (who pay tax on the sale of property) will not be affected by this change and will still be able to claim interest as an expense.

It remains unclear whether “New Builds” will be exempt from the new interest limitation rule and we understand consideration will be given to this as well as considering whether all people who are taxed on the sale of a property (for example under the bright-line test) should be able to deduct their interest expense at the time of the sale.

Please note the above proposals have yet to go through a formal consultation process. Therefore, watch this space for further developments!

How can Chapmans help?

Many of you are already experiencing reduced rental deductions from the new loss ring fencing rules. However, please do not hesitate to contact us to discuss how the above changes will apply to you and whether it might be timely to review your investments and current debt structure to see if there are any options available.

Consideration should also be given to the potential increase in tax liability that is likely to result from these changes and we can also assist with planning for this outcome.